

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 65 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
2. To be referred to the Reporter or not?
3. Whether Their Lordships wish to see the fair copy of the judgement?
4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
5. Whether it is to be circulated to the Civil Judge?

COMMISSIONER OF INCOME-TAX

Versus

MODERN ENGINEERING & MOULDING CO.

Appearance:

MR MANISH R BHATT for Petitioner

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA.

MR.JUSTICE A.R. DAVE

Date of decision: 22/12/98

ORAL JUDGEMENT

1. At the instance of revenue, following question arising out of Income Tax Appellate Tribunal's order in in ITA No. 2203/Ahd/1979 for the assessment year 1975-76 in the case of respondent assessee has been referred to this court for its opinion:

"Whether on the facts and in the circumstances of the case, the Appellate Tribunal has been right in law in holding that the action of the Income-tax Officer in taxing the amount of Rs.29,492/- as assessee's income under Section 41(i) of the Income-tax, 1961 cannot be justified?"

2. The facts of the case are that for the assessment year 1970-71, assessee was found to have entered into certain bogus purchase entries for which deduction had been allowed while computing taxable profits for that year. The assessment for the assessment year 1970-71 had been reopened and reassessment has taken place and the amount represented by bogus purchases have been added and those proceedings were completed. The assessee unilaterally in his books of account discharged himself of this liability by crediting the amount representing bogus purchases and carrying to the profit and loss account. It appears that the assessee agreed at some stage for additions of this amount for the current year in question presumably to mitigate these rigour of submitting false particulars on earlier occasion. The Tribunal on appeal found that a debtor cannot by his unilateral act discharge himself of his liability, and by such unilateral declaration neither any income accrues nor can be said to be amount received or receivable by the assessee which has earlier been allowed as deduction for the purpose of Section 41(1) of the Income Tax Act, so as to include in the income of the assessee during the year in which such liability is written off.

3. In our opinion there is a fundamental difference between a debt owed and debt owned by a person. While debt owned is an asset or property of a person which he can always relinquish or part with company by his voluntary act. Discharge of liability does not depend upon his volition. It does not affect the remedies or rights of the third party to whom such debt is owed, nor absolves a person, who has written off such liability in his books of account from that liability. Moreover, in the facts of the present case, it is apparent that if deduction has wrongly been allowed in respect of bogus purchases in the earlier year, such deductions can be recalled by appropriate proceedings which in the present case had in fact been initiated and taken. But in case the

transactions are held to be valid merely because subsequently the purchaser declines to pay purchase price it cannot be considered as profit of the person who was failed to make his obligation to pay. If that were so, every default in payment would result in consequential income for the debtor liable to tax under Section 41(1), for which a deduction has earlier been allowed by considering it to be an expense.

4. Moreover, it is a case where case of the revenue is that in the Assessment Year 1970-71 there was a bogus entry of purchases that is to say liability to pay such purchase price too was bogus. No liability in fact ever existed. Striking out of such entries from books of account cannot result in obtaining any amount in respect of such loss, or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof. It becomes a case of a deduction on account of expenses having been wrongly allowed in earlier year because of non disclosure or wrong disclosure of facts relevant to that assessment year.

5. Operation of Section 41(1) envisage that in the first instance the assessee had incurred some loss or expenses or liability in earlier year which was allowable as deduction and such allowance was made and in subsequent year either the assessee had received some amount of cash or obtained some benefit as a result of remission or cessation of the liability. Remission of liability can be an act of other party and not of assessee's own. So also cessation of liability may be for many reasons, but certainly it cannot be attributed on the part of the assessee to refuse to discharge such liability. When the liability, loss or expenses in fact did not exist in first place, no question of receiving any amount or benefit in respect thereof arise. The expression obtained or received cash or benefit relates to act of some other agency other than assessee.

6. We are of the opinion that the Tribunal has rightly reached this conclusion that such a writing off of liability cannot result in receipt of expenses which have been incurred or allowed in earlier assessment, when the assessee decides not to pay the debt, or in respect of nonexistent expenditure wrongly allowed in earlier assessment year on realising that fact in later assessment year.

Accordingly, the question referred to is answered in affirmative, that is in favour of the assessee and against the revenue.

There shall be no order as to costs.

(Rajesh Balia, J)

(A.R. Dave, J)